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MICHAEL RODAK, JR.,

Supreme Court of the United States

No. 73-2017

October Term, 1974

BROCK & BLEVINS CO., INC., *et al.*,
Petitioners,

vs.

R. J. BRYAN,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Fifth Circuit

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BROCK & BLEVINS CO., INC., *et al.*,
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vs.

R. J. BRYAN,
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PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Fifth Circuit

To The Honorable, The Chief Justice and the Associate Justices of the Supreme Court of The United States:

Your petitioners respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered February 27, 1974, a timely filed petition for rehearing having been denied April 16, 1974.

CITATIONS TO OPINIONS BELOW

The opinion of the district court entered June 2, 1972, and published at 343 F. Supp. 1062 and the judgment of permanent injunction of the district court are presented

in the appendix to this petition at pages A1 and A17 respectively. The Court of Appeals decision and judgment of February 27, 1974, published at 490 F.2d 563 are reprinted in the appendix to this petition at pages A19 and A35 respectively. The order of the Court of Appeals denying the petition for rehearing was entered April 16, 1974.

JURISDICTION

The judgment of the Court of Appeals was entered on February 27, 1974. The petition for rehearing was denied April 16, 1974.

The jurisdiction of this court is invoked under the provisions of 28 U.S.C. Section 1254.

QUESTIONS PRESENTED

1. Whether the Circuit Court erred in finding that it had pendent jurisdiction to affirm the case on the basis of the law of the State of Georgia.

2. Whether the Georgia corporate merger statutes permit the "freeze out" of a minority stockholder by merger with the sole remedy being appraisal rights in the absence of any fraud.

UNITED STATES STATUTES INVOLVED

15 U.S.C. Section 78j. Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of

interstate commerce or of the mails, or of any facility of any national securities exchange—

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. Section 240.10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange—

(a) to employ any device, scheme, or artifice to defraud.

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATE OF GEORGIA STATUTES INVOLVED

The State Statutes involved are 22 Georgia Code Annotated, Section 1001, 22 Georgia Code Annotated, Section 1003, 22 Georgia Code Annotated, Section 1201, and 22 Georgia Code Annotated, Section 1202, which due to their length have been set forth in the Appendix at page A37.

STATEMENT OF THE CASE

Brock & Blevins Co., Inc. (hereinafter referred to as "Brock & Blevins") is a Georgia corporation incorporated in 1950, and has its principal place of business in Rossville, Georgia. Brock & Blevins' principal business is the fabrication of steel products, heavy industrial maintenance and the installation of electric generating equipment. The principal asset of Brock & Blevins is its managers and specifically the managers of the various divisions and the salaried personnel.

Brock & Blevins has always been a closely-held corporation with active employees holding stock in the corporation. Historically when a stockholder left the active employment of Brock & Blevins any such shareholder then sold the stock to either the corporation or to another shareholder who remained active in the business. The plaintiff, R. J. Bryan, was an active employee of Brock & Blevins until October, 1970, and had acquired a 15% stock ownership in the corporation through petitioner, W. G. McGlothlin, at the cost of $30,000. The plaintiff held various jobs with Brock & Blevins and resigned as executive vice president and a member of the board of directors in October of 1970.

Prior to his resignation, Mr. Bryan had discussed the sale of his stock with various persons.

After the resignation of Mr. Bryan, the petitioners entered into a course of negotiations whereby a fair value would be established and paid to the plaintiff for his stock in Brock & Blevins. These negotiations failed through informal discussions. A meeting was then held on November 16, 1971, and the plaintiff was contacted by James B. Frost, Certified Public Accountant, who represented both the plaintiff and Brock & Blevins and a meeting was scheduled with the plaintiff for November 18, 1971, at Mr. Frost's office. Attending this November 18, 1971, meeting were Mr. and Mrs. R. J. Bryan, Attorney Sydney W. Carpenter, representing Brock & Blevins, and Mr. James B. Frost. Mr. Carpenter informed the plaintiff that the stockholders of Brock & Blevins wished to implement the company policy and to eliminate the plaintiff as an inactive minority shareholder but in doing so they wanted to treat the plaintiff fairly. At this meeting, plaintiff was furnished with various financial statements and other relevant documents in connection with the financial and earnings picture of Brock & Blevins. The plaintiff was also furnished with the detailed work sheets which included equitable and generous extensions and projections through December 31, 1971. The financial information given to the plaintiff was the most current financial information available to Brock & Blevins at the time and the plaintiff was advised that Brock & Blevins stood ready and willing to furnish any further information which he requested. The information furnished by Brock & Blevins to the plaintiff fully satisfied all the requirements of the Georgia merger statutes.

At the meeting of November 18, 1971, Mr. Carpenter submitted two alternative offers to the plaintiff. The proposals made by Mr. Carpenter on behalf of Brock & Blevins were as follows:

1. $290,000 cash for plaintiff's stock or
2. $200,000 cash for plaintiff's stock plus another $200,000 over a ten year period in return for an agreement not to compete with Brock & Blevins for a ten year period.

At this meeting, Mr. Carpenter explained to the plaintiff that if he refused the proposals made to him, the defendants were contemplating a plan of merger under which the plaintiff's stock would be acquired for cash or he could elect to dissent from the plan of merger, and thereby be entitled to receive his appraisal remedies under the Georgia corporate statutes. Plaintiff was informed of the fact that if he elected to be treated as a dissenter he would receive fair value for his stock pursuant to the Georgia appraisal statutes, which the petitioners deemed to be approximately the same as the proposals.

It became apparent that Mr. Bryan would not accept the proposal and on November 29, 1971, the employees of Brock & Blevins who are also shareholders proceeded with their merger plan. They entered into an agreement to form Power Erectors, Inc., a Georgia corporation. The parties to this agreement agreed to become shareholders in Power Erectors and agreed to exchange their stock in Brock & Blevins for a proportionate amount of stock in Power Erectors. On November 30, 1971, Power Erectors was duly incorporated with its principal place of business in Rossville, Georgia. As a result of the exchange of the stock by the shareholders who were active employees of Brock & Blevins, they became the sole shareholders of Power Erectors. Power Erectors became the owner of 85% of the stock in Brock & Blevins and the plaintiff remained as the owner of 15% of the stock in Brock & Blevins. In the agreement to form Power Erectors,

the active employees of Brock & Blevins who were shareholders in Brock & Blevins expressly agreed that only employees active in Power Erectors or the controlled subsidiary would be allowed to be shareholders of Power Erectors.

On December 2, 1971, a special meeting of the board of directors of Power Erectors was held and the directors approved the submission of a plan of merger to the shareholders of Power Erectors whereby Brock & Blevins would be merged into Power Erectors.

Also on December 2, 1971, a special meeting of the board of directors of Brock & Blevins was held and the directors of Brock & Blevins approved the submission to the shareholders of Brock & Blevins of the plan of merger whereby Brock & Blevins would be merged into Power Erectors and called for a shareholders' meeting to be held on December 22, 1971, to consummate the plan of merger.

A notice of the Brock & Blevins shareholders' meeting was mailed to the plaintiff on December 2, 1972, which notice included the plan of merger of Brock & Blevins into Power Erectors and all other relevant financial information for Brock & Blevins and Power Erectors.

The plan of merger provided that the outstanding stock of Brock & Blevins would be cancelled and in exchange the Brock & Blevins shareholders other than Power Erectors would receive $483.33 per share for their stock in Brock & Blevins. Therefore, the plaintiff was to receive $290,000 for his stock in Brock & Blevins which the petitioners had previously determined to be the fair value of the stock. The plaintiff had the alternative of (1) accepting $290,000 for his stock, or (2) dissenting from the plan of merger pursuant to the Georgia merger stat-

utes and receiving the "fair value" for his stock as determined by the Georgia State Courts, but not less than $290,000.

On December 17, 1971, the plaintiff filed suit in the United States District Court for the Northern District of Georgia at Rome, Georgia, requesting that the Court issue a temporary restraining order and that a permanent injunction be issued upon a trial of the case. The restraining order and permanent injunction sought to restrain the defendant from adopting the plan of merger whereby Brock & Blevins would merge into Power Erectors. Jurisdiction of the United States District Court was invoked pursuant to the Securities Exchange Act of 1934. The complaint alleged violations of Section 10(b) of the Securities Exchange Act and of Rule 10(b)-5 of the Rules of the Securities and Exchange Commission. The plaintiff contended that the application of the Georgia merger statutes perpetrated a fraud upon him in violation of the Securities Exchange Act. The pleadings dealt with other allegations of fraud in the management of Brock & Blevins which were not alleged to be violations of the Securities Exchange Act or of the Georgia merger statutes.

Upon the filing of the suit, the District Court issued an ex parte temporary restraining order enjoining the proposed merger. A trial on the merits was held on January 21, 1972, without the intervention of a jury.

In an opinion filed on June 2, 1972, the District Court did not find the defendants guilty of any of the acts of fraud alleged in the complaint, but did find the defendants guilty of a violation of the Securities and Exchange laws.

A final order was entered pursuant to the District Court's opinion on June 8, 1972.

Neither the plaintiff's complaint nor the District Court's opinion relied upon the doctrine of pendent jurisdiction. The complaint was based upon alleged violations of the federal securities laws, constitutional issues and corporate mismanagement. The opinion of the District Court was based on allegations of violations of the securities laws and found the defendant in violation of these laws.

On appeal to the United States Court of Appeals for the Fifth Circuit, the Fifth Circuit held that it was not required to decide the securities law issues involved in the case upon which the District Court based its opinion. The Fifth Circuit stated that the doctrine of pendent jurisdiction was applicable and held that the actions of the defendants were in violation of the plaintiff's rights under Georgia state law. The Circuit Court decided the case on the basis of pendent jurisdiction determining Georgia state law on a theory not raised in the complaint and not considered by the District Court.

In rendering its decision, the Fifth Circuit considered the action taken by the defendants to be in violation of Georgia law when there was no Georgia decision to look to for guidance and when all other states which had considered the issues involved had rendered decisions in conflict with the Circuit Court's decision. Furthermore, all federal courts that have been requested to consider similar claims based on pendent jurisdiction have refused to do so.

REASONS FOR GRANTING WRIT

1. The decisions below deserve the attention of this Court because the decision of the Fifth Circuit with respect to pendent jurisdiction decided an important question of federal law which should be settled by the Supreme Court; the decision was in conflict with decisions in other circuits; and the decision was in conflict with an applicable decision of this Court.

The Circuit Court, in its opinion affirming the District Court, clearly misapplied the doctrine of pendent jurisdiction in finding that the Fifth Circuit had pendent jurisdiction to decide the case in the manner in which the case was decided. The Fifth Circuit decided the case upon a construction of the Georgia state law and a theory of Georgia state law which was not raised in the complaint nor decided by the District Court. The complaint alleged, and the District Court found, a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities Exchange Commission and the Circuit Court found it unnecessary to review the findings of such violations by the District Court. Neither the plaintiff nor the District Court considered, claimed or asserted that there existed a state claim over which the doctrine of pendent jurisdiction would be applicable. Thus, there was no claim upon which the test of interrelationship between federal and state claims could be had and the Fifth Circuit needlessly decided a significant state law issue which should have been avoided as a matter of comity and left to a state tribunal to decide. *United Mine Workers of America v. Gibbs*, 383 U.S. 715 (1966).

In cases decided by district courts in other circuits where allegations of Securities Exchange Act violations were the basis of the jurisdiction of the court and these allegations were not sustained it has been uniformly held that the claims under the state corporate law could not be decided by the federal courts under the doctrine of pendent jurisdiction. *Krafcisin v. LaSalle Madison Hotel Co.*, Civil No. 70 C 2968 (District Court, Ill., decided June 19, 1972); *Drier v. The Music Makers Group, Inc., et al.*, CCH Fed. Sec. L. Rep. §94,406 (S.D.N.Y. 1974).

The decision of the Fifth Circuit also appears to be in conflict with the rationale of a recent decision of this court. See *Lehman Brothers v. Schein*, ... U.S. ....., 94 S. Ct. 1741 (1974). *Lehman Brothers* involved a case in which federal jurisdiction was based on diversity and this court held that because of the novelty of the question of state law involved and the unsettled status of the state law, the decision of the Second Circuit Court of Appeals should be remanded so that the Court of Appeals could reconsider whether the Florida state laws involved should be decided by a Florida tribunal.

The rationale for a determination by a Georgia tribunal in this case is even more compelling than in *Lehman Brothers*. *Lehman Brothers* involved a diversity case and federal courts consistently have to decide state law in diversity cases. In the instant case, the jurisdiction of the federal court was invoked pursuant to the Securities Exchange Act of 1934. The Fifth Circuit decided that the alleged violation of the Securities Exchange Act did not have to be decided by them but proceeded to decide the case on the basis of pendent jurisdiction. It is obvious that it is less compelling for a federal court to decide a state law question pursuant to the doctrine of pendent

jurisdiction than it is to decide a state law question where the case is before the federal court on diversity jurisdiction.

In the *Lehman Brothers* case, although the highest court in Florida had not considered the applicable question, several Florida district courts of appeal decisions provided some guidance to the federal court for its decision but this Court held that the state law question should be decided by a Florida tribunal. In the instant case the Fifth Circuit emphasized in its opinion that there were no Georgia decisions construing the applicable Georgia statutes but the Fifth Circuit proceeded to decide the case in the manner in which it felt the Georgia courts would decide the case.

It is clear that pendent jurisdiction should not have been invoked in this matter by the Fifth Circuit and the peculiar questions of state law involved should have been decided by a Georgia tribunal.

2. In deciding that the Georgia corporate statutes would not permit a corporation to be created and merged with another corporation in order to eliminate a stockholder, the decisions below decided an important state question in conflict with the applicable state law.

The Fifth Circuit decided that the Georgia corporation statutes would not permit a corporation to be created and merged with another corporation resulting in the elimination of a stockholder. The Fifth Circuit held that the petitioners' acts were "clearly a violation of the plaintiff's right under state law". The Fifth Circuit cited no Georgia authority for its position. The Fifth Circuit based its opinion on vague language in *Lebold v. Inland Steel Co.*, 125 F.2d 369 (7th Cir., 1941) and *Pepper v. Litton*, 308

U.S. 295 (1939). Both of these cases are completely distinguishable from the instant case. Neither case involved a merger. *Pepper* involved a defendant-controlling stockholder who was dealing with himself to the detriment of the corporation's creditors. In *Lebold* a corporation was dissolved and prior to the dissolution the defendants had illegally stripped the corporation of its assets and thus substantially reduced the fair market value of the minority stockholders' stock. But most importantly, in neither *Lebold* nor *Pepper* were appraisal rights available to the minority shareholders or creditors.

In the instant case, there were no findings with respect to self-dealing and there were no allegations of a reduction of the fair market value of the plaintiff's stock. There were appraisal remedies available to the plaintiff in the instant case which were not available in *Lebold* and *Pepper*. These appraisal remedies assured the plaintiff of receiving fair market value for his stock. The Fifth Circuit ignored the availability of the statutory right of the plaintiff to the appraisal remedy which would satisfy any equitable right which the plaintiff might have.

As noted by the Fifth Circuit, neither party cited Georgia cases with respect to whether the Georgia statutes would authorize the plan of merger to be carried out by the petitioners. This was because there are no Georgia cases in point. The Fifth Circuit did recognize that the Georgia statutes were based on the New York Business Corporation Act. However, the Fifth Circuit failed to look to the New York laws or decisions in construing the Georgia statutes. It is well established that in construing statutes the legislative intent must be looked to, especially in the absence of judicial interpretation. The official comments to the Georgia statutes specifically direct

attention to the New York Business Corporation Law. There is judicial interpretation of the New York Business Corporation Law and, therefore, the Fifth Circuit was required by Georgia law to look to the New York cases in construing the Georgia statutes. *Todd v. State*, 228 Ga. 746, 187 S.E.2d 831 (1972); *Tamiami Trail Tours, Inc. v. Georgia Public Service Commission*, 213 Ga. 418, 99 S.E.2d 225 (1957).

It is clear from a review of the New York cases construing the New York Business Corporation Law that a stockholder does not have an absolute right to continue as a stockholder in the successor corporation but may be forced to accept cash for his stock pursuant to a plan of merger. *Beloff v. Consolidated Edison Company of New York*, 300 N.Y. 11, 87 N.E.2d 561 (1949); *Blumenthal v. Roosevelt Hotel, Inc.*, 202 Misc. 988, 115 N.Y.S.2d 52 (Sup. Ct., 1952); *Willcox v. Stern*, 18 N.Y.2d 195, 273 N.Y.S.2d 38 (1966).

Courts in other states interpreting statutes similar to the Georgia merger and appraisal statutes have also held that these statutes allow the majority stockholders of the corporation to force a minority to accept cash for their interest in the corporation. See *Carl Marks & Co., Inc. v. Universal City Studios, Inc.*, 233 A.2d 63 (Del. Sup. Ct., 1967); *Gerstell v. Allentown Portland Cement Company*, 30 Pa. D. & C.2d 223 (1963); *Bruce v. E. I. Bruce Company*, 40 Del. Ch. 80, 174 A.2d 29 (1961); and *Johnson v. Baldwin*, 69 S.E.2d 585 (So. Car. Sup. Ct., 1952).

Therefore the Fifth Circuit incorrectly decided an important Georgia state law question by basing its decision on antiquated cases in which the aggrieved party had no appraisal remedy and where the value of the stock

of the corporation had been illegally reduced. If the Circuit Court had correctly applied the Georgia law with respect to legislative construction and looked to the laws of New York and of other jurisdictions in determining how the Georgia courts would construe the Georgia corporate merger statutes, a different decision would have been reached.

CONCLUSION

For all the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

THOMAS A. CALDWELL, JR.

and

ROGER W. DICKSON

Attorneys for Petitioners

OPINION OF THE DISTRICT COURT

(Filed June 2, 1972)

Civil Action File No. 2385

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

R. J. BRYAN,
Plaintiff,

vs.

BROCK & BLEVINS CO., INC., *et al.*,
Defendants.

ORDER

This action arises under Section 10(b) of the Securities Exchange Act of 1934 [15 U.S.C.A. §78j]; and Rule 10b-5 of the Securities Exchange Commission [17 C.F.R. §240.10b-5 (1964)]. This Court has jurisdiction of this action under Section 27 of said act, 15 U.S.C.A. §78aa, as amended. Robert J. Bryan, plaintiff herein, has instituted this action for the purpose of permanently enjoining the proposed merger of Brock & Blevins Co., Inc. with Power Erectors, Inc., defendants herein.

Plaintiff is a citizen and resident of Chattanooga, Tennessee. Defendants, Brock & Blevins Co., Inc. and Power Erectors, Inc., are business corporations, organized and existing under the laws of the State of Georgia. The registered agent for service of process for defendant, Power Erectors, Inc., is George P. Shaw, Attorney at Law, of LaFayette, Georgia.

This matter proceeded to trial before the Court without a jury on the question of a preliminary injunction and on the merits under the provision of Rule 65(a)(2), F.R.C.P. It having been determined that the plaintiff was mentally incompetent at the time of the hearing, the Court appointed Mrs. Amy E. Bryan, wife of plaintiff, as guardian ad litem.

The question presented to the Court is whether the acts of the defendants constitute fraud so as to be in violation of the Securities and Exchange Act and the rules of the Commission promulgated thereunder.

FINDINGS OF FACT

Brock & Blevins Co., Inc. (hereinafter Brock & Blevins), was incorporated in 1950 as a Georgia corporation having its principal place of business in Rossville, Walker County, Georgia. Prior to 1950, Brock & Blevins had operated as a partnership. The business of Brock & Blevins was the manufacture of machinery of all kinds; the maintenance, operation and conducting of foundries and foundry business; the maintenance and operation of machine shops, and assembly plants; the business of assembling and erecting power plants, chemical plant equipment and other heavy machinery of any kind, character or description; engaging in the general steel and iron construction business; and the carrying on of a general industrial service and erection of all kinds of iron construction and industrial service. The original stockholders of Brock & Blevins were J. A. Brock, W. G. McGlothlin and H. E. Shrader.

Robert J. Bryan, a chemical engineer with a Bachelor of Science Degree from the University of Wisconsin, was employed by Brock & Blevins in 1955. Bryan's position with the company at that time was varied in that he

was working on special problems, following up sales and contracts, and traveling. He maintained this status with the company for some two and one-half years at which time he was appointed General Manager on June 13, 1957. Bryan began serving on the Board of Directors of Brock & Blevins in 1960 and was elected to the office of Executive Vice-President in that same year. Bryan served on the Board of Directors and as an officer of the company from 1960 until his resignation on October 17, 1970. Bryan's resignation was predicated upon a severe problem in company management, and he felt that his termination as an active employee in the management of Brock & Blevins was for the best interest of the company's future. Bryan has retained his status as an inactive stockholder in the company up to the time of the threatened merger in December, 1971, of Brock & Blevins with Power Erectors, Inc.

The present company management maintains that there is a long-standing company policy of Brock & Blevins having only "active employees" as shareholders. They have used this policy to support the instigation of the threatened merger which is the foundation of this controversy. Asserting the existence of this company policy, the defendants have made various attempts to acquire Bryan's stock by what they describe as a "fair value" offer.

On October 14, 1970, the first attempt at such acquisition took place during a visit in Trenton, Georgia, between Bryan and Judge Paul W. Painter, a director of Brock & Blevins. Bryan indicates that he might possibly have contemplated a sale of his stock to the corporation for the purpose of getting new people in the company. The purchase price was to be based only upon agreeable terms, with Bryan's suggestion that an appropriate starting point

might be the book value, plus additional factors to arrive at the value of the "going concern," and then take fifteen (15) percent of that calculation to represent his share. This particular meeting laid the foundation for the assumption that Bryan would sell if an attractive and deserving offer were negotiated.

Bryan was then contacted in May of 1971 by Judge Painter who initiated his interest in purchasing the stock. Bryan responded with a willingness to discuss the matter, but a formal meeting was never arranged. During this same interval of Judge Painter's correspondence, Bryan was contacted by Bill Hicks, an individual non-employee, who also expressed an interest in purchasing the stock. This expression of interest also failed to materialize.

Bryan was first approached with a value offer on August 21, 1971, during a luncheon engagement in Chattanooga with Judge Painter. Judge Painter conveyed an offer of $200,000 for the stock on the premise that he was the representative for the other "stockholders." Bryan's reaction to the offer was that the price was too low, and Judge Painter responded by saying that he was authorized to offer only $200,000 and that he could not negotiate further.

Bryan was not approached again until November 16, 1971, at which time Frost and Frost, Certified Public Accountants for defendant Brock & Blevins, acting through a partner, Jim Frost, called plaintiff to come to his office to discuss "a problem." It was related that W. G. McGlothlin, president of Brock & Blevins, had engaged a Chattanooga law firm concerning this matter. A meeting was scheduled for November 18, 1971, at the offices of Frost & Frost. This meeting was attended by Sydney W. Carpenter, Attorney for the law firm of Stophel,

Caldwell & Heggie of Chattanooga, representing Brock & Blevins; James B. Frost, Certified Public Accountant for Brock & Blevins; and Mr. and Mrs. R. J. Bryan. Carpenter informed Bryan that the "stockholders" wanted to buy his stock, but in so doing, they intended a fair treatment of Bryan. At the meeting, Bryan was given an appraisal prepared by Mr. Daniel W. Lattimore, an S.R.A. and M.A.I. appraiser and real estate consultant from Chattanooga, together with a number of analyzed reports, audits and balance sheets as an indication of Brock & Blevins' past economic history. Included within these documents was an unaudited calculation of the estimated progress of the company through June 30, 1971. Carpenter then submitted to Bryan two alternate offers, one of which would have to be accepted by noon on Monday, November 22, 1971. The offers were:

> (1) Two Hundred Ninety Thousand ($290,000) Dollars cash for his stock or,
>
> (2) Two Hundred Thousand ($200,000) Dollars cash for his stock, plus another Two Hundred Thousand ($200,000) Dollars over a ten-year period in return for an agreement not to compete with Brock & Blevins for the same ten-year period.

Carpenter stated that his law firm had advised McGlothlin that fundamental corporate changes would be necessary in order to acquire Bryan's stock if he refused to accept one of the offers, and the necessary legal proceedings would begin immediately upon such refusal. Bryan was fully apprised of the contemplated merger plan which would find him a dissenter and qualified to receive only appraisal remedies under the 1969 Georgia Corporation Statutes. Carpenter advised Bryan that the proposed merger plan would not be carried out if one of the two offers was accepted within the allowable time period.

On November 19, 1971, Bryan called Frost to clarify whether or not the two offers were presented as an ultimatum, and Frost advised Bryan that the offers and deadline were intended as such. On November 22, 1971, Bryan let the deadline pass without a decision. Frost called Bryan and asked if a decision had been reached, and Bryan responded in the negative. Frost relayed the message to Carpenter, and on November 23, 1971, Carpenter called Bryan with an offer for more time in which to contemplate a decision. Bryan stated that such a time period would still be far too short and again contended the offer was far below the true value of the stock; and furthermore, he advised that he did not want to sell his stock. Carpenter then advised Bryan that appropriate legal proceedings would commence immediately.

On November 26, 1971, Judge Painter, a member of the Board of Directors of Brock, approached Bryan, "as his friend," in order to admonish Bryan of the probable expenses to be realized when seeking the professional advice of an attorney in a situation of this nature.

On November 29, 1971, the "active" shareholders of Brock & Blevins entered into an agreement to form a new corporation, Power Erectors, Inc. Pursuant to the agreement, all shareholders in Brock & Blevins, except Bryan, exchanged their stock holdings in Brock & Blevins for a proportionate amount of stock in Power Erectors, Inc. As a result of that exchange, Power Erectors, Inc. became the owner of 85 percent of the stock in Brock & Blevins and Bryan remained as the owner of 15 percent of the stock. The initial Board of Directors of Power Erectors, Inc. was, W. G. McGlothlin, Paul W. Painter, J. E. Wright, N. A. Dunn and J. J. Underwood. W. G. McGlothlin was the incorporator and majority stockholder in Power Erectors, Inc. There were no preemptive rights

in that company. On November 30, 1971, Power Erectors, Inc. was duly incorporated under the Georgia corporation statutes having its principal place of business in Rossville, Walker County, Georgia.

On December 2, 1971, upon waiver of notice, a special meeting of the Board of Directors of Power Erectors, Inc. was held in Rossville, Georgia. As chairman of the meeting, W. G. McGlothlin stated that the purpose of the meeting was to consider recommending to the shareholders of the company a plan of merger whereby Brock & Blevins would be merged into Power Erectors, Inc. Upon motion duly made and seconded, the following resolution was unanimously adopted:

> RESOLVED, that the Board of Directors of Power Erectors, Inc. recommend to its shareholders that Brock & Blevins Co., Inc. be merged into Power Erectors, Inc. in accordance with the plan of merger which was presented and reviewed at this meeting; and
>
> FURTHER RESOLVED, that the secretary of this corporation be, and hereby is, instructed to give notice in accordance with law of a special meeting of the shareholders of Power Erectors, Inc. to consider this plan of merger, such meeting to be held at 316 Chickamauga Avenue, Rossville, Georgia, on December 22, 1971, at 10:00 A.M.

Under the plan of merger, the stock owned by Power Erectors, Inc. in Brock & Blevins would be cancelled and Bryan would receive $290,000 for his stock.

On December 2, 1971, a notice of the December 22, 1971, shareholders meeting of Brock & Blevins was mailed to Bryan and was received by him on December 3, 1971. Included in the notification were several reports and audits of Brock & Blevins' past economic history. It was reported

in the notice that the 1971 profit and loss report of Brock & Blevins was included, when in fact the year had not ended. A highly contested factual dispute exists as to whether this indication was an error or an intentional act of fraudulent misrepresentation. The Court finds that it was a false statement, whether intended as such or not.

The plaintiff has alleged that the "plan of merger" is a device, scheme and artifice to defraud him of his status as a shareholder in an existing corporation. It is alleged that this is a violation of the Securities and Exchange Act and the General Rules and Regulations of the Securities and Exchange Commission, and this suit is instituted for the purpose of permanently enjoining the proposed merger of the two corporations.

CONCLUSIONS OF LAW

The applicable part of the Securities Exchange Act of 1934, 15 U.S.C.A. 78j provides:

> "It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> **(a)** . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 of the Commission, 17 C.F.R. 240.10b-5 (1964) provides:

> "It shall be unlawful for any person, directly or indirectly by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or cause of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

The sole question for consideration by this Court is as stated above; whether the acts as alleged and proved by the plaintiff constitute fraud so as to be in violation of the 1934 Securities and Exchange Act and the rules of the Commission promulgated thereunder.

Exclusive jurisdiction in the United States District Court is provided for under 15 U.S.C. §78aa.

> "The district courts of the United States . . . shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder. . . . Any suit or action . . . to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business . . ."

In order to invoke proper jurisdictional requirements and to substantiate a cause of action under the Securities and Exchange laws, it must be shown that a "sale" of securities was pursuant to the transaction. Under the theory expressed in *Vine v. Beneficial Finance Company,* 374 F.2d 627 (2nd Cir. 1967), the "plan of merger" constituted a sale of securities. This same principle was adopted by the Fifth Circuit in the case of *Dudley v. Southeastern Factor and Finance Corporation,* 446 F.2d 303 (5th Cir. 1971), where the Court in an exhaustive study of this subject, said,

> ". . . a shareholder should be treated as a seller when the nature of his investment has been fundamentally changed from an interest in a going enterprise into a right solely to a payment of money for his shares." (p. 307)

Another requirement that must be satisfied under the applicable statutes is the "use of the mails." The defendants concede that the use of the mails was employed as a means of correspondence, and the Fifth Circuit allows for a private right of action when a violation of the Securities and Exchange laws arises through a use of the mail facilities. See, *Hooper v. Mountain States Securities Corporation,* 282 F.2d 195 (5th Cir. 1960). The Court finds as a matter of law that there was a sale of the securities by use of the mails, and that the United States District Court for the Northern District of Georgia is properly endowed with jurisdiction over the parties and subject matter of the controversy. See also, *J. I. Case Co. v. Borak,* 377 U.S. 426 (1964), where the Court said that federal courts will provide the remedies required to carry out the congressional purpose of protecting federal rights.

The basis of the defendants' contentions rest on the principle that the Georgia corporation statutes allow the

majority stockholders of a corporation to force a minority shareholder to accept cash for his interest in the corporation through a merger agreement. In support of this argument, defendants have cited several state court decisions which adhere to this principle, and the defendants assert that this authority should be followed by this Court. A thorough investigation of this law by the Court reveals that several jurisdictions do, in fact, provide for such corporate procedures; however, only if no fraud be shown as an accompanying vice in accomplishing such transaction. Every case cited by defendants alternatively provides for equitable relief where there is fraud or illegality in a merger transaction, despite the existence of an appraisal remedy. In the absence of fraudulent activity in the merger proceedings, the defendants' position is conceivably supported by law.

The defendants have asserted the validity of their position even if the more restrictive procedures of Professor Vorenburg's Harvard Law Review article are followed. *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* 77 Harv.L.Rev. 1189 (1964). The purpose of Professor Vorenburg's article was to suggest that only if there exists a "plausible business purpose" of the corporation beyond the desire of the majority to enhance their own stock holdings or merely eliminate a minority shareholder should the minority holder be forced into the position of a dissenter. Professor Vorenburg's analysis does not advocate an absolute right of minority elimination when appraisal remedies are available for fear that the allowance of an absolute freeze-out will enable the majority to contemplate a depressed market, invoke corporate merger procedures, and obtain the minority's shareholdings at a reduced value. In view of this learned approach, the Court's conclusion as to the status of the so-called long-standing

company policy will determine the "plausible business purpose" doctrine.

In all due respect to the defendants' allegation that such policy is deeply entrenched in the corporation's philosophy, the Court's conclusion is that such policy was nonexistent. This factual dispute has been one of great concern to the Court, but a decision must be made and testimonial conflicts weigh in favor of the plaintiff as to the existence of such policy. Judge Painter had been Assistant Secretary of the company since May 9, 1959; and in the face of such deep-rooted company policy, he approached Bryan in an attempt to purchase his stock. Judge Painter was not then, and never has been, an active employee of the company. The Court is curiously puzzled as to Judge Painter's apparent unawareness of such a cohesive company force. The decision of Brock & Blevins' active shareholders to exchange their stock for that in Power Erectors, Inc. resulted in two shareholders in Brock & Blevins, (1) Bryan and (2) Power Erectors, Inc. Neither of these shareholders was or is an active employee of Brock & Blevins Co., Inc. Nowhere in the by-laws of Brock & Blevins does the Court find any reference to such long-standing company policy. Bryan himself testified in his deposition (p. 138) that he was unaware of any established company policy. Also, there was considerable evidence as to the possibility of going public which of course would be inconsistent with such alleged policy. Together with other factual disputes, the Court finds that the long-standing company policy was non-existent. Without such support, the defendants' proposed merger transaction is void of a "plausible business purpose."

In analysis of the issue of fraud, the Court will consider its interpretation of the facts in view of the alleged statutory violation.

In the first instance, reference should be made to the basic principle of fiduciary relationships in a corporate structure. The old case of *Pepper v. Litton*, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 284 (1939) expressed these principles most appropriately. In finding the director, as well as the dominant or controlling stockholder or group of stockholders, in a fiduciary capacity, the Court said:

> "Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. . . . The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside." (p. 306)

The "active shareholders" and directors of Brock and Blevins were in a fiduciary relationship with Bryan at the time of their decision to exchange their stock for stock in Power Erectors, Inc., and their decision can hardly be interpreted to have been made in the best interest of Bryan as a minority shareholder. Bryan was given no opportunity to exchange his Brock & Blevins stock for Power Erectors, Inc. stock. Instead, the active shareholders of Brock & Blevins, Bryan's fiduciaries, created an arbitrary requirement for stockholders in Power Erectors, Inc., which adhered to the alleged company policy of Brock & Blevins. The Court has previously determined that no such company policy prevails; and the inventive creation of such nebulous policy standard is a scheme and contrivance in violation of the parties' fiduciary trust.

In regard to the possibility of "going public" and acquiring Chattanooga Boiler and Tank Co., the Court finds that these possibilities had reached the status of probabilities and were of serious concern to all Brock & Blevins stockowners. The evidence before this Court reveals that these expansion considerations were rapidly approaching the consummation stage, and such probable enhancement of the company's business would certainly sway one's decision to sell or hold his company interests. Bryan had every right to this information, and the failure to disclose such developments was a manipulative and deceptive device in violation of the Securities and Exchange laws. The Court is unimpressed with the defendant's argument that Bryan was fully aware of the recent developments of these possible business moves. Bryan was not aware of their viable nature, and the full command of his decision necessitated such knowledge.

The manipulative and deceptive devices provision of the Securities Exchange Act is fully discussed in the case of *Herpich v. Wallace*, 430 F.2d 792 (5th Cir. 1970):

> "By Section 10(b) Congress meant to prevent manipulation and control of the prices at which securities are bought and sold and to enable buyers, sellers, and traders of securities to make a proper appraisal of the value of the securities . . . . (p. 801) A fundamental purpose of the Act was 'to substitute a philosophy of full disclosure for the philosophy of caveat emptor' . . . . (p. 801) Together the section and the rule aim at reaching 'misleading or deceptive activities, whether or not they are precisely and technically sufficient to sustain a common law action for fraud and deceit,' . . . carried on 'in connection with' the purchase or sale of securities. They are not intended as a specification of particular acts or prac-

> tices that constitute 'manipulative or deceptive devices or contrivances,' but are instead designed to encompass the infinite variety of devices that are alien to the 'climate of fair dealing' . . ." (p. 802)

The Court went further to say that the operative terms of the manipulative and deceptive devices rule must be given broad and flexible construction so as to effectuate the remedial purposes of the statute and rule. Any manipulative or deceptive device or contrivance which would cause a reasonable investor to rely thereon is meant to be outlawed. The provision is not so much concerned with fraud per se as it is with the effect of fraud upon the investor. The District Court in *Kuenhert v. Texstar Corporation*, 286 F.Supp. 340 (S.D. Texas 1968), expressed its interpretation of "fraud" within the Securities and Exchange laws; citing *Cochran v. Channing Corp.*, 211 F.Supp. 239 (S.D., N.Y. 1962):

> "The Securities Exchange Act was enacted in part to afford protection to the ordinary purchaser or seller of securities. Fraud may be accomplished by false statements, a failure to correct a misleading impression left by statements already made or, as in the instant case, by not stating anything at all when there is a duty to come forward and speak. It is the use of the inside information that gives rise to a violation of Rule 10b-5." (p. 344)

The law is similarly stated in other jurisdictions and further recitation would appear redundant. Suffice it to say that the acts alleged and proved fall within the statutory interpretations as set out above. See also, *Heit v. Weitzen, et al.*, 402 F.2d 909 (2nd Cir. 1968). *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir. 1971).

In conclusion, the Court must find a violation of the Securities Exchange Act and the rules of the Commission promulgated thereunder. The law as stated is obviously a protective device to discourage and hopefully prevent the very activities which transpired in this controversy. Although some authority exists which permits such corporate procedures, that authority terminates its permission when fraudulent activities are involved. The Court is aware that fraud is a most difficult and ambiguous area in which to reach supportable conclusions; however, legal precedent is a comforting guideline. This Court's review of the applicable legal precedent necessitates its conclusion. The information deliberately withheld from Bryan was an omission or failure to state a material fact and a statutory violation. The creative birth of Power Erectors, Inc., with its alleviating restrictions, was a device, scheme, or artifice to defraud Bryan of his stock. The Court has found that the sole purpose and intent of the organization of Power Erectors and the proposed merger was the elimination of the plaintiff. The proposed merger itself was a course of business which would operate as a fraud or deceit upon Bryan, in connection with the sale of his stock. It is of mysterious wonder to the Court as to why Brock & Blevins waited one year to effectuate what was claimed to be a such deep-rooted and stringent company policy. To allow Brock & Blevins to arbitrarily select a time in which to forcefully exclude a minority's interest through unlawful employment of an apparently lawful procedure is not to be condoned by this Court.

> "Equitable relief against a freezeout is generally more appropriate where a close corporation is involved. Valuation difficulties caused by the absence of a market for the shares may vitiate his appraisal right, and even if he receives economic fair value, his personal

'proprietary' interest remains uncompensated." *Freezing Out Minority Shareholders,* 74 Harv.L.Rev. 1631 (1961).

The Court finds for the plaintiff and the petition to enjoin the proposed merger of Brock & Blevins Co., Inc. into Power Erectors, Inc. is hereby GRANTED.

IT IS SO ORDERED this 2nd day of June, 1972.

/s/ WILLIAM C. O'KELLEY
United States District Judge

JUDGMENT OF THE DISTRICT COURT

(Filed June 8, 1972)

Civil Action File No. 2385

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

R. J. BRYAN,
Plaintiff,

vs.

BROCK & BLEVINS CO., INC., *et al.,*
Defendants.

JUDGMENT OF PERMANENT INJUNCTION

THIS CAUSE came on to be heard under the provisions of Rule 65 (a) (2), F.R.C.P., and the Court having heretofore, on the 2nd day of June, 1972, filed and entered

an Order in this cause containing findings of fact and conclusions of law, and it having been determined therein that the proposed merger of Brock & Blevins Co., Inc. into Power Erectors, Inc. should be permanently enjoined, therefore

IT IS ORDERED, ADJUDGED AND DECREED that the defendants and each of them, their officers, agents, representatives, employees, attorneys, and all persons in active concert and participation with them, be and they are permanently enjoined and restrained from proceeding further with the proposed merger of Brock & Blevins Co., Inc. into Power Erectors, Inc., and such proposed merger is hereby permanently enjoined and restrained.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the defendants pay the costs of these proceedings, to be taxed by the Clerk of this Court, and that execution issue for the same.

This 8th day of June, 1972.

/s/ WILLIAM C. O'KELLEY
United States District Judge

OPINION OF THE COURT OF APPEALS

(Dated February 27, 1974)

No. 72-3601

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

R. J. BRYAN,
Plaintiff-Appellee,

vs.

BROCK & BLEVINS CO., INC., *et al.*,
Defendants-Appellants.

Appeal from the United States District Court for the Northern District of Georgia.

Before TUTTLE, THORNBERRY and RONEY, *Circuit Judges.*

TUTTLE, *Circuit Judge*:

This appeal raises the question whether the Georgia Merger Statute, Section 22-1001 et seq., including the right of the merged corporation to eliminate a dissenting stockholder upon an appraisal and acquisition of his stock, can be used solely for the purpose of "freezing out" a minority dissenting stockholder.

Jurisdiction in the United States District Court was obtained by virtue of the filing of a complaint in which the plaintiff alleged specific violations of the requirements of Section 10(b) of the Securities Exchange Act of 1934, and Rule 10(b)(5) of the Securities & Exchange Commission. The complaint also alleged, however, that the manner

in which the defendants attempted to utilize the Georgia Corporation Merger Statute was, in and of itself, a "device, scheme and artifice to defraud" which the plaintiff, as the holder of a 15% stock interest in the merged corporation could enjoin. Pendent jurisdiction attaches to the second claim and permits the court to consider it independently of the provisions of the Securities Exchange Act, even though jurisdiction of the court was not alleged on diversity grounds.[1]

The absence of any claim here by the appellant that there was not sufficient evidence upon which the trial court could make its conclusion that "the sole purpose and intent of the organization of Power Erectors and the proposed merger was the elimination of the plaintiff" and that "the proposed merger itself was a course of business which would operate as a fraud or deceit upon Bryan, in connection with the sale of his stock,"[2] enables us to repeat some of the findings of the trial court which set out the circumstances leading up to the transaction that is here under attack.

FINDINGS OF FACT

Brock & Blevins Co., Inc., (hereinafter Brock & Blevins), was incorporated in 1950 as a Georgia corporation having its principal place of business in Rossville, Walker County, Georgia. Prior to 1950, Brock & Blevins had operated as a partnership. The business of Brock & Blevins was the manufacture of machinery of all kinds; the maintenance, operation and conducting of foundries and foundry business; the maintenance and operation of

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1. There was not complete diversity as to the individual parties. Nor was the jurisdictional amount alleged.

2. The appellants challenge the correctness of the conclusions, but they do not attack specifically any of the historical facts recited below.

machine shops, and assembly plants; the business of assembling and erecting power plants, chemical plant equipment and other heavy machinery of any kind, character or description; engaging in the general steel and iron construction business; and the carrying on of a general industrial service and erection of all kinds of iron construction and industrial service. The original stockholders of Brock & Blevins were J. A. Brock, W. G. McGlothlin and H. E. Shrader.

Robert J. Bryan [the plaintiff in this action], a chemical engineer with a Bachelor of Science Degree from the University of Wisconsin, was employed by Brock & Blevins in 1955. Bryan's position with the company at that time was varied in that he was working on special problems, following up sales and contracts, and traveling. He maintained this status with the company for some two and one-half years at which time he was appointed General Manager on June 13, 1957. Bryan began serving on the Board of Directors of Brock & Blevins in 1960 and was elected to the office of Executive Vice-President in that same year. Bryan served on the Board of Directors and as an officer of the company from 1960 until his resignation on October 17, 1970. Bryan's resignation was predicated upon a severe problem in company management, and he felt that his termination as an active employee in the management of Brock & Blevins was for the best interest of the company's future. Bryan has retained his status as an inactive stockholder in the company up to the time of the threatened merger in December, 1971, of Brock & Blevins with Power Erectors, Inc.

The present company management maintains that there is a long-standing company policy of Brock & Blevins having only "active employees" as shareholders. They have used this policy to support the instigation of the

threatened merger which is the foundation of this controversy. Asserting the existence of this company policy, the defendants have made various attempts to acquire Bryan's stock by what they describe as a "fair value" offer.

Bryan was then contacted in May of 1971 by Judge Painter who initiated his interest in purchasing the stock. Bryan responded with a willingness to discuss the matter, but a formal meeting was never arranged. During this same interval of Judge Painter's correspondence, Bryan was contacted by Bill Hicks, an individual non-employee, who also expressed an interest in purchasing the stock. This expression of interest also failed to materialize.

Bryan was first approached with a value offer on August 21, 1971, during a luncheon engagement in Chattanooga with Judge Painter. Judge Painter conveyed an offer of $200,000 for the stock on the premise that he was the representative for the other "stockholders." Bryan's reaction to the offer was that the price was too low, and Judge Painter responded by saying that he was authorized to offer only $200,000 and that he could not negotiate further.

Bryan was not approached again until November 16, 1971, at which time Frost and Frost, Certified Public Accountants for defendant Brock & Blevins, acting through a partner, Jim Frost, called plaintiff to come to his office to discuss "a problem." It was related that W. G. McGlothlin, president of Brock & Blevins, had engaged a Chattanooga law firm concerning this matter. A meeting was scheduled for November 18, 1971, at the offices of Frost & Frost. This meeting was attended by Sydney W. Carpenter, Attorney for the law firm of Stophel, Cald-

well & Heggie of Chattanooga, representing Brock & Blevins; James B. Frost, Certified Public Accountant for Brock & Blevins; and Mr. and Mrs. R. J. Bryan. Carpenter informed Bryan that the "stockholders" wanted to buy his stock, but in so doing, they intended a fair treatment of Bryan. At the meeting, Bryan was given an appraisal prepared by Mr. Daniel W. Lattimore, an S.R.A. and M.A.I. appraiser and real estate consultant from Chattanooga, together with a number of analyzed reports, audits and balance sheets as an indication of Brock & Blevins' past economic history. Included within these documents was an unaudited calculation of the estimated progress of the company through June 30, 1971. Carpenter then submitted to Bryan two alternate offers, one of which would have to be accepted by noon on Monday, November 22, 1971. The offers were:

(1) Two Hundred Ninety Thousand ($290,000) Dollars cash for his stock or,

(2) Two Hundred Thousand ($200,000) Dollars cash for his stock, plus another Two Hundred Thousand ($200,000) Dollars over a ten-year period in return for an agreement not to compete with Brock & Blevins for the same ten-year period.

Carpenter stated that his law firm had advised McGlothlin that *fundamental corporate changes would be necessary in order to acquire Bryan's stock if he refused to accept one of the offers, and the necessary legal proceedings would begin immediately upon such refusal.* Bryan was fully apprised of the contemplated merger plan which would find him a dissenter and qualified to receive *only appraisal remedies under the 1969 Georgia Corporation Statutes.* Carpenter advised Bryan that the proposed merger plan would not be carried out if one of the two

offers was accepted within the allowable time period. (Emphasis added).

On November 19, 1971, Bryan called Frost to clarify whether or not the two offers were presented as an ultimatum, and Frost advised Bryan that the offers and deadline were intended as such. On November 22, 1971, Bryan let the deadline pass without a decision. Frost called Bryan and asked if a decision had been reached, and Bryan responded in the negative. Frost relayed the message to Carpenter, and on November 23, 1971, Carpenter called Bryan with an offer for more time in which to contemplate a decision. Bryan stated that such a time period would still be far too short and again contended the offer was far below the true value of the stock; and furthermore, he advised that he did not want to sell his stock. Carpenter then advised Bryan that appropriate legal proceedings would commence immediately.

On November 26, 1971, Judge Painter, a member of the Board of Directors of Brock, approached Bryan, "as his friend," in order to admonish Bryan of the probable expenses to be realized when seeking the professional advice of an attorney in a situation of this nature.

On November 29, 1971, the "active" shareholders of Brock & Blevins entered into an agreement to form a new corporation, Power Erectors, Inc. Pursuant to the agreement, all shareholders in Brock & Blevins, except Bryan, exchanged their stock holdings in Brock & Blevins for a proportionate amount of stock in Power Erectors, Inc. As a result of that exchange, Power Erectors, Inc. became the owner of 85 percent of the stock in Brock & Blevins and Bryan remained as the owner of 15 percent of the stock. The initial Board of Directors of Power Erectors, Inc. was, W. G. McGlothlin, Paul W. Painter, J. E. Wright, N. A. Dunn and J. J. Underwood. W. G.

McGlothlin was the incorporator and majority stockholder in Power Erectors, Inc. There were no preemptive rights in that company. On November 30, 1971, Power Erectors, Inc. was duly incorporated under the Georgia corporation statutes having its principal place of business in Rossville, Walker County, Georgia.

On December 2, 1971, upon waiver of notice, a special meeting of the Board of Directors of Power Erectors, Inc. was held in Rossville, Georgia. As chairman of the meeting, W. G. McGlothlin stated that the purpose of the meeting was to consider recommending to the shareholders of the company a plan of merger whereby Brock & Blevins would be merged into Power Erectors, Inc. Upon motion duly made and seconded, the following resolution was unanimously adopted:

> RESOLVED, that the Board of Directors of Power Erectors, Inc. recommend to its shareholders that Brock & Blevins Co., Inc. be merged into Power Erectors, Inc. in accordance with the plan of merger which was presented and reviewed at this meeting; and
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> FURTHER RESOLVED, that the secretary of this corporation be, and hereby is, instructed to give notice in accordance with law of a special meeting of the shareholders of Power Erectors, Inc. to consider this plan of merger, such meeting to be held at 316 Chickamauga Avenue, Rossville, Georgia, on December 22, 1971, at 10:00 A.M.

Under the plan of merger, the stock owned by Power Erectors, Inc. in Brock & Blevins would be cancelled and Bryan would receive $290,000 for his stock.

On December 2, 1971, a notice of the December 22, 1971, shareholders meeting of Brock & Blevins was mailed to Bryan and was received by him on December 3, 1971.

Included in the notification were several reports and audits of Brock & Blevins' past economic history. It was reported in the notice that the 1971 profit and loss report of Brock & Blevins was included, when in fact the year had not ended. A highly contested factual dispute exists as to whether this indication was an error or an intentional act of fraudulent misrepresentation. The Court finds that it was a false statement, whether intended as such or not.

The plaintiff has alleged that the "plan of merger" is a device, scheme and artifice to defraud him of his status as a shareholder in an existing corporation. It is alleged that this is a violation of the Securities and Exchange Act and the General Rules and Regulations of the Securities and Exchange Commission, and this suit is instituted for the purpose of permanently enjoining the proposed merger of the two corporations.

The applicable part of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> (a) . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

We agree with the trial court that the proposed transaction whereby, under the Georgia Corporation Merger Statute, Bryan could be forced to surrender his stock to the corporation in return for cash at an appraised value amounts to a "sale" under this Act. *Dudley v. Southeastern Factor and Finance Corp.*, 446 F.2d 303 (5th Cir. 1971).

The trial court found as a fact that there were two false statements made by the defendant corporation Brock & Blevins Co., Inc. and its officers. The first of these was the statement contained in the letter delivered to Bryan to the effect that the financial statement for the year 1971 was enclosed. There was no 1971 financial statement, and there could be none, since the letter was delivered in November and the year would not end until December 31st. The other was a failure to inform Bryan of the present posture of certain negotiations Brock & Blevins was carrying on with respect to a potential acquisition of one or two additional companies. The trial court found that these two omissions gave right to a claim under the Securities Act because they were used in connection with the sale of a security. Both the findings of fact that these elements were false and the applicability of section 78j(b) are challenged by the appellants. Because of the disposition we make of the case it is not necessary for us to resolve these issues.

Rule 10b-5 of the Commission, 17 C.F.R. 240.10b-5 (1964) provides:

> It shall be unlawful for any person, directly or indirectly by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, . . .

(c) To engage in any act, practice, or cause of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

The trial court concluded that the acts of the defendants in setting up a second corporation solely for the purpose of enabling them to utilize the Georgia Corporations Merger Act[3] as a means to force Bryan, as a dissenting stockholder, to lose his stock interest in the resulting corporation was "a device, scheme, or artifice to defraud Bryan of his stock." The appellants contend that "under these provisions of the Georgia merger statutes, a minority shareholder may be required to accept cash in full payment for his shares in the merging corporation." We agree that this is the purport of the Georgia statute, which is based on section 623 of the New York Business Corporation Law, McKinney's Consol.Laws, c. 4. Appel-

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3. "The manner and basis of converting the shares of each merging corporation into shares or other securities or obligations of the surviving corporation and, if any shares of any of the merging corporations are not to be converted solely into shares or other securities of the surviving corporation, *the amount of cash* or securities of any other corporation, or combination of cash and such securities, which is to be paid or delivered to the holders of such shares in exchange for or upon the surrender of such shares, *which cash* or securities of any other corporation or combination of cash and such securities, *may be in addition to or in lieu of the shares or other securities of the surviving corporation.* (Emphasis supplied)." Ga.Code Ann. § 22-1001(b)(3).

"Upon filing a notice of election to dissent, the shareholder shall cease to have any of the rights of a shareholder except the right to be paid for the fair value of his shares. . . ." Ga.Code Ann. § 22-1202(d).

"The enforcement by a shareholder of his right to receive payment for his shares in the manner provided in this section shall exclude the enforcement by such shareholder of any other right to which he might otherwise be entitled by virtue of share ownership, except as provided in subsection (d) of this section, and except where the corporation by fraud has induced the shareholder to enforce his dissenter's rights." Ga.Code Ann. § 22-1202(j).

lants contend that the trial court's determination that "the proposed merger itself was a course of business which would operate as a fraud or deceit upon Bryan, in connection with the sale of his stock" amounted in effect to a holding that "the proposed merger pursuant to Georgia merger statute was a violation of federal securities law *per se*." Of course, the trial court did not decide any such thing. It decided that where a corporation is unable, because of well recognized contract law to eliminate a minority stockholder by simply adopting a by-law or voting to purchase his stock, its majority stockholders cannot accomplish the same purpose by setting up a second corporation wholly owned by them whose sole purpose is to enable it to take advantage of the merger statutes which, when utilized by two existing corporations, may, as a part of the merger procedures result in the elimination of a dissenter.

There is little law on this subject, although similar efforts by corporations to eliminate minority interests by the majority vote to liquidate a corporation followed by acquisition of the going business by the same persons who hold the majority stock ownership have been subject to considerable litigation.

In *Lebold v. Inland Steel Co.*, 125 F.2d 369 (7 Cir. 1941) the court held that the plaintiff, a minority stockholder of the Inland Shipping Company, could recover damages incurred by him by reason of acts of the defendant Inland Steel Company, controlled by common directors and officers, in dissolving the steamship company, buying its assets and appropriating its business. The theory of plaintiffs was that the defendant, owning some 80% of the stock of the steamship company had so utilized its prominent position as majority stockholder as to force the latter company out of a prosperous going business, to bring

about its dissolution and to take over its property and its business to the detriment of plaintiffs. The trial court dismissed the complaint. In reversing that action the Court of Appeals said:

> "What defendant might have accomplished under color of the West Virginia statute was discontinuance of the business. What it did, was to take, through form of a sale, the physical assets and the entire business of the Steamship Company. Whether we stamp the happenings as dissolution or with some other name, equity looks to the essential character and result to determine whether there has been faithlessness and fraud upon the part of the fiduciary. However proper a plan may be legally, a majority stockholder cannot, under its color, appropriate a business belonging to a corporation to the detriment of the minority stockholder. The so-called dissolution was a mere device by means of which defendant appropriated for itself the transportation business of the Steamship Company to the detriment of plaintiffs. That the source of this power is found in a statute, supplies no reason for clothing it with a superior sanctity, or vesting it with the attributes of tyranny. Allied Chemical & Dye Corp. v. Steel & Tube Co. of America, 14 Del. [Ch.] 1, 120 A. 486. The books are full of instances of disapproval of such action. If it be an absorption by the dominant member of all the returns of the corporate investment, or a sale of the property to oneself for an inadequate consideration, or deprivation by a syndicate formed to freeze out a minority stockholder through sale and dissolution or if the buyer and seller are the same, the right of a stockholder to vote becomes a power in trust when he owns the majority and assumes and exercises domination and control over cor-

porate affairs. Such majority stockholders' vote 'must not be so antagonistic to the corporation as a whole as to indicate that their interests are wholly outside of the interest of the corporation and destructive of the interests of the minority shareholders.'" (citations omitted).

The case of *Pepper v. Litton*, 308 U.S. 295, 60 S.Ct. 238, 84 L.Ed. 281 (1939) is also instructive. It was largely relied upon by the court in the *Lebold* case, *supra*. Speaking of the dominant stockholder or majority, the Supreme Court said in *Pepper*:

> "He cannot violate rules of fair play by doing indirectly through the corporation what he could not do directly. He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements. For that power is at all times subject to the equitable limitation that it may not be exercised for the aggrandisement, preference, or advantage of the fiduciary to the exclusion or detriment of the *cestuis*. Where there is a violation of those principles, equity will undo the wrong or intervene to prevent its consummation."

The trial court here simply held that the dominant stockholder interests in this case utilized the Georgia Corporation Merger Statute to accomplish something that they could not accomplish directly. The finding was to the effect that a new corporation was set up, having no business purpose of its own and no pre-existing viability of any kind, solely for the purpose of effecting a "freeze-out," which Professor Vorenburg, Exclusiveness of the Dissenting Stockholder's Appraisal Right, 77 HARVARD LAW REVIEW, 1189 (1964) describes by saying:

> For our purposes, the nub of the problem is that an absolute freeze-out right would mean that those in control rather than the stockholder himself would decide when he shall sell his stock.

It was with this concept in mind, that the trial court found the absence of a "business purpose" for the proposed merger of Brock and Blevins into Power Erectors. In the absence of such business purpose Power Erectors was purely a sham party created to circumvent the rule of law that prohibits a majority of stockholders of a corporation, absent any charter provision as to the contrary, to force the minority interests to surrender their stock holdings. Implicit in this holding was a construction of the Georgia statute that comports with equity in good conscience. Such construction would read out of the statute a situation where there was no pre-existing corporation to be merged, but instead where such corporation was created solely for the purpose of accomplishing an illegal result. Such construction is clearly warranted by the language quoted above from *Pepper*:

> He cannot use his power for his personal advantage and to the detriment of the stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements.

The trial court used this determination to permit it to conclude that there had been a violation of the Securities Exchange Act and the regulations promulgated by the Securities & Exchange Commission. The court held that such a procedure "was a course of business which would operate as a fraud or deceit upon Bryan, in connection with the sale of his stock."

Appellants contend that whatever the plan of procedure was, it did not fall within the prohibitions of the law because it had nothing to do with enabling the dissenting stockholder to consider or decide to make any commitment with respect to the sale of stock. In our opinion, this is a close question which we do not have to decide.

In the complaint, Bryan alleged specifically that this procedure is a "device, scheme and artifice to defraud," and further, "such plan was adopted by the directors in rubber stamp approval of Mr. McGlothlin's plan and solely as a device to confiscate plaintiff's investment at less than its true value, after he refused to sell at the price offered to him by McGlothlin." Further the complaint alleged, "Every plan of merger authorized by Georgia law (Code Annotated 22-1001) contains an implied condition that the parties to it will act in good faith and deal fairly with each other in adopting such plan," and then further:

> Because the Board of Directors of Brock and Blevins Co., Inc. adopted such resolution to merge said corporations for the sole purpose of confiscating plaintiff's property, the plan itself is a fraud and because such sham merger constitutes a manipulative and deceptive device and contrivance in violation of the rules and regulations of the Securities & Exchange Commission, the adoption of the plan of merger by the shareholders should be enjoined by this court.

Regardless of whether the device, found by the court to be fraudulent as against the plaintiff, was a violation of the Securities Exchange Act, it was clearly a violation of the plaintiff's rights under state law. While neither party cites a single Georgia case, we have no doubt that the pronouncements contained in the Court of Appeals decision from the Seventh Circuit, and the Supreme Court decision referred to above, clearly state the local law to be applied by a federal district court in equity.

As stated at the outset, jurisdiction was acquired by the allegations relating to the violations of the Securities Exchange Act. These allegations presented a serious and material question for the court to decide. Any equitable cause of action that would lie under the same proof and the same findings of the trial court can properly be adjudicated under the district court's pendent jurisdiction over a state cause of action. We think that the case so clearly establishes the right of the plaintiff to the relief granted by the trial court under general principles of corporation law, which we have discussed above, that we pretermit a determination as to whether the trial court correctly related the misuse of the Georgia statute to the Securities Exchange law, and approve the decision on the basis of general equity and state law grounds. See, on the question of resort to compulsory appraisal for the purpose of "freezing out" a minority stockholder, 77 HARVARD L.R., *supra*.

This disposition of the case also makes it unnecessary for us to determine whether there were adequate grounds for the trial court's determination that there were two other violations of the Securities Exchange Act. The evidence was conflicting as to both, but a question remains as to whether the actions of Bryan, who was "under the gun" to dispose of his stock by virtue of an entirely different set of circumstances (the merger gambit) could in any way have been affected or influenced by such conduct by the defendants. We do not reach this issue but it may be that the plan to create a sham corporation to effect a merger really undercut whatever had happened before. The relief which we conclude the plaintiff is entitled to because of this situation is full and complete, and we think it therefore unnecessary to deal with the other question as to violations of Section 10(b) or the supplementary regulations.

The judgment of the trial court is affirmed.

JUDGMENT OF THE COURT OF APPEALS

(Filed April 29, 1974)

No. 72-3601

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

R. J. BRYAN,
Plaintiff-Appellee,

vs.

BROCK & BLEVINS CO., INC., *et al.*,
Defendants-Appellants.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Georgia, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed;

It is further ordered that defendants-appellants pay to plaintiff-appellee, the costs on appeal to be taxed by the Clerk of this Court.

COURT OF APPEALS LETTER DENYING PETITION FOR REHEARING AND REHEARING EN BANC

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

April 16, 1974

To ALL COUNSEL OF RECORD

Re: No. 72-3601—*Bryan v. Brock & Blevins Co., Inc., et al*

Gentlemen:

This is to advise that an order has this day been entered denying the petition for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the petition for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,

EDWARD W. WADSWORTH
Clerk

By /s/ SUSAN LEBRUN
Deputy Clerk

cc: Mr. Charles J. Gearhiser
Mr. George Paul Shaw
Mr. Frank M. Gleason

STATE OF GEORGIA STATUTES

22 Georgia Code Annotated, Section 1001. Procedure for Merger—

(a) Any two or more domestic corporations may merge into one of such corporations pursuant to a plan of merger approved in the manner provided in this Code (Chapters 22-1 through 22-20).

(b) The board of directors of each corporation shall, by resolution adopted by each such board, approve a plan of merger setting forth:

(1) The names of the corporations proposing to merge, and the name of the corporation into which they propose to merge, which is hereinafter designated as the surviving corporation.

(2) The terms and conditions of the proposed merger.

(3) The manner and basis of converting the shares of each merging corporation into shares or other securities or obligations of the surviving corporation and, if any shares of any of the merging corporations are not to be converted solely into shares or other securities of the surviving corporation, the amount of cash or securities of any other corporation, or combination of cash and such securities which is to be paid or delivered to the holders of such shares in exchange for or upon the surrender of such shares, which cash or securities of any other corporation, or combination of cash and such securities, may be in addition to or in lieu of the shares or other securities of the surviving corporation.

(4) A statement of any changes in the articles of incorporation of the surviving corporation to be effected by such merger.

(5) Such other provisions with respect to the proposed merger as are deemed necessary or desirable.

22 Georgia Code Annotated, Section 1003. Approval by Shareholders—

(a) The board of directors of each corporation, upon approving such plan of merger or plan of consolidation, shall, by resolution, direct that the plan be submitted to a vote at a meeting of shareholders, which may be either an annual or special meeting: Provided, if a plan of merger will not effect any change in or amendment to the articles of incorporation of the surviving corporation, and if either no new shares of the surviving corporation are to be issued or any new shares of the surviving corporation to be issued under the plan of merger can be issued by the board of directors without further authorization by the shareholders of the surviving corporation, the plan of merger need not be submitted to the shareholders of such corporation, unless the articles of incorporation of such corporation provide otherwise. If a merger is effected without submission of a plan of merger to the shareholders of the surviving corporation as provided in this subsection (a), the fact of such merger, an outline of the material features of the plan thereof, and the financial condition of the merged corporation or corporations as shown in the most recent annual balance sheets and annual profit and loss statements of such corporation or corporations shall be disclosed to the shareholders of the surviving corporation in the next annual financial statement covering the fiscal year in which the merger is effected that is furnished by the surviving corporation to all its shareholders or, if practicable, in the first notice of dividend or share distribution that is furnished to the holders of each class or series of its shares between the effective date of the merger and the next

such financial statement, and in any event to all its shareholders within 12 months of the effective date of the merger.

(b) (1) Written notice shall be given to each shareholder of record, whether or not entitled to vote at such meeting, not less than 20 days before such meeting, in the manner provided in section 22-604 for the giving of notice of meetings of shareholders, and, whether the meeting be an annual or a special meeting, shall state that the purpose or one of the purposes is to consider the proposed plan of merger or consolidation: Provided, that no such notice need be given to the shareholders of the surviving corporation where such corporation, in accordance with subsection (a) of this section, does not submit the plan of merger to its shareholders, or to the shareholders of any of the constituent corporations in a merger effected pursuant to section 22-1005 relating to the merger of subsidiary corporations into their parent.

(2) The notice shall contain a clear and concise statement that if the plan of merger or consolidation is effected shareholders dissenting therefrom are entitled, if they file a written objection to such plan before the vote of the shareholders is taken thereon and comply with the further provisions of section 22-1202 regarding the rights of dissenting shareholders, to be paid the fair value of their shares. A copy of the plan of merger or consolidation or an outline of the material features of the plan, together with a copy of the most recent annual balance sheet and annual profit and loss statement of each of the merging or consolidating corporations, shall accompany such notice.

(c) At each such meeting, a vote of the shareholders shall be taken on the proposed plan of merger or consolida-

tion. The plan of merger or consolidation shall be approved upon receiving the affirmative vote of the holders of a majority of the shares entitled to vote thereon of each corporation required to submit such plan to its shareholders, unless any class of shares of any such corporation is entitled to vote thereon as a class, in which event, as to such corporation, the plan of merger or consolidation shall be approved upon receiving the affirmative vote of the holders of a majority of the shares of each class of shares entitled to vote thereon as a class and of the total shares entitled to vote thereon. Any class of shares of any such corporations shall be entitled to vote as a class if the plan of merger or consolidation, as the case may be, contains any provision which, if contained in a proposed amendment to the articles of incorporation, would entitle such class of shares to vote as a class.

(d) After the plan of merger or consolidation has been approved, and at any time prior to the filing of the articles of merger or consolidation with the clerk of the superior court as provided in section 22-1004 (d) and (e), the merger or consolidation may be abandoned pursuant to provisions therefor, if any, set forth in the plan of merger or consolidation.

22 Georgia Code Annotated. Section 1201. Right of Shareholders to Dissent—

(a) Any shareholder of a corporation shall have the right to dissent from any of the following actions:

(1) Any plan of merger or consolidation to which the corporation is a party. . . .

22 Georgia Code Annotated, Section 1202. Rights of Dissenting Shareholders—

(a) Any holder of record of either voting or non-voting shares intending to exercise his right of dissent shall file with the corporation, before the meeting of shareholders at which the proposed corporate action is submitted to a vote, or at such meeting but before the vote, written objection to the action. The objection shall include a statement that he intends to demand payment of the fair value of his shares if the action is taken. Such objection is not required from any shareholder to whom the corporation did not give notice of such meeting as provided in this Code (Chapters 22-1 through 22-20) or where the proposed action is authorized by written consent of shareholders without a meeting. . . .

(j) The enforcement by a shareholder of his right to receive payment for his shares in the manner provided in this section shall exclude the enforcement by such shareholder of any other right to which he might otherwise be entitled by virtue of share ownership, except as provided in subsection (d) of this section, and except where the corporation by fraud has induced the shareholder to enforce his dissenter's rights. If a shareholder does not enforce his dissenter's rights pursuant to this section, or if he elects to enforce such rights but for any reason loses them or withdraws his election as permitted in subsection (d) of this section, nothing in this section shall be construed as barring him from bringing or maintaining an appropriate action to obtain relief on the ground that the corporate action in question will be or is unlawful or fraudulent as to him. . . .